

MEMORANDUM

To: Audit Committee Members:
Mr. Eugene Pettis, Chairman
Ms. Valerie Boyd, Member
Mr. William E. Graham, Member
Ms. Betsy Krant, Member
Mr. Frank Williamson, Jr., Member
Ms. Barbara A. Markham, Ex Officio
Mr. James D. Yager, Ex Officio
Carolyn Williams, Director, Office of Supplier Diversity and Outreach

From: Allen Vann, Inspector General, Office of Inspector General

Date: September 9, 1996

Subject: Audit of Everglades Management Services, Inc. (EMS) Application for
Minority/Woman Business Enterprise (M/WBE) Certification -
Audit # 96 -03

INTRODUCTION

This report presents the results of our audit of the M/WBE Application for Certification (the "M/WBE Application"), supporting documentation and other related information as submitted by EMS. EMS filed an M/WBE Application with the District on March 27, 1996, the same day the Articles of Incorporation were filed with the State of Florida. According to the M/WBE Application, Mr. Henry Garza is the sole stockholder and Vice President of EMS. Mr. Garza purportedly shares responsibility for business operations with two other corporate officers: Ms. Tammy Egerton, who is the President of EMS, and Ms. Mandy Milstead, its Secretary/Treasurer. EMS received District M/WBE certification on May 21, 1996, for the business of landscaping.

The Articles of Incorporation listed EMS's mailing address as 13053 Bryan Road, Loxahatchee, Florida, Attention: Mr. Avery Milstead. This property is owned by Mr. Milstead who is the principal owner of several businesses that do business with the District. The officers of EMS list prior employment with Mr. Milstead's companies on their resumes.

Our audit was performed pursuant to a request from the District's Director of Supplier Diversity and Outreach, dated August 9, 1996.

OBJECTIVE

The purpose of our audit was to determine if EMS meets the criteria for M/WBE eligibility.

This audit was conducted pursuant to the Office of Inspector General's responsibilities and authority set forth in ' 20.055 F.S. Our audit was conducted according to *Generally Accepted Government Auditing Standards* and included such tests of EMS records and other auditing procedures we considered necessary under the circumstances. We examined the M/WBE Application and EMS's proposal (RFP # C-8550 Operations of Navigational Lock Structures), which contained relevant financial and other information. We also examined the financial records provided by EMS for the period March 27, 1996, through August 13, 1996. We also interviewed EMS's sole shareholder/owner and other officers and consultants.

Our auditors did not discuss specific findings with EMS. However, audit matters were discussed to the extent necessary to obtain a full understanding of the items in the certification documents and evidentiary documents furnished in support of the submission.

BACKGROUND

The District is currently contracting the locktender services to Palmdale Oil Co., Inc. (Palmdale), which is performing under a three year contract expiring on September 30, 1996.

The Procurement and Contracts Division issued Request for Proposal (RFP) C-8550, on May 8, 1996, to procure locktender services for the next three year period. The District received four responses: Palmdale, EMS, Hydro Science, and Edna Hines. The proposal review committee consisting of three Regional Directors from the Operations and Maintenance Department, one Civil Engineer from the Engineering & Project Management Division, and one Governmental Representative from the Okeechobee Service Center, ranked Palmdale and EMS number 1 and number 2, respectively. All respondents to the RFP were informed on June 21, 1996, of the decision to select Palmdale as the contractor.

EMS filed a written Notice of Protest on June 26, 1996, and a Formal Written Protest on July 5, 1996. On July 11, 1996, the District's Governing Board directed negotiations with Palmdale and EMS for a bifurcated contract. Subsequently, Palmdale filed a Notice of Protest on July 12, 1996, followed by a Formal Written Protest on July 22, 1996. Items of **ADisputed Issues of Material Fact** in both protests cited allegations of fraud with regard to their competitor's qualifying for points they were awarded for meeting the minimum M/WBE participation goal, thereby, receiving an unfair competitive advantage. We have conducted a parallel audit addressing EMS's assertions regarding Palmdale's minority subcontractor.

Criteria

The authority to conduct an examination of an M/WBE Application for Certification is described in the signed affidavit which is included with the M/WBE Application. The affidavit states:

". . . the undersigned agrees to provide the Certifying Agency with current, complete and accurate information regarding THIS APPLICATION, its attachments, or any project or contracts issued by the organizations or corporations utilizing the AGENCY for their own minority/women or disadvantaged business enterprise procurement and/or construction programs. The undersigned further agrees that, as part of this certification procedure, the AGENCY may freely contact any person or organization named in this application to verify statements made in THIS APPLICATION and/or secure additional information or data required to grant to, or withhold from, the applicant company certification as an MBE, WBE, or DBE. The undersigned understands and agrees that failure to submit required materials and/or to consent to interview(s), audit(s), and /or examination(s) will be grounds for immediate rejection of the application for certification or recertification."

In addition, authority to periodically review a firm's continued M/WBE eligibility is stated in the M/WBE Certification Approval letter issued by the District.

On May 24, 1991, the District issued MBE Certification Guidelines (the "Guidelines") which specify certification criteria. The criteria were established based on the standard definition for minority and women-owned business enterprises as contained in the "Florida Small and Minority Business Assistance Act," [FS 288.703] and the District's Procurement and Contracting Policy.

FINDINGS

Our assessment of EMS's eligibility as an M/WBE firm according to specific elements of the District's Guidelines follows:

Minority Business Enterprise:

a minority business enterprise is a small business concern which is domiciled in Florida and which is at least 51 percent owned by minority persons and whose management and daily operations are controlled by such persons.

EMS is domiciled in Florida and owned by a minority person.

Minority Persons:

permanent residents of Florida who are members of minority groups as noted in Sections 288.702 and 288.703, Florida Statutes.

The EMS owner and sole stockholder is a permanent resident of Florida and a member of a minority group.

Small Business:

an independently owned and operated business concern which employs 25 or fewer permanent full-time employees, and which has a net worth of not more than \$1 million.

EMS falls within the definition of a small business.

Organized to engage in commercial transactions:

the applicant company must be organized to perform a commercially useful function according to the customs and practices within their respective industry. A business concern is considered to perform a commercially useful function if it assumes responsibility for the performance, management and supervision of a distinct element of work on a contract and/or the business assumes the actual and contractual responsibility for the provision of materials and supplies.

Based on the M/WBE Application, EMS's primary business is landscaping, land management, native restoration, and land maintenance. We confirmed this with the Articles of Incorporation.

As of the date of the M/WBE Application (March 27, 1996) there were no business activities. Subsequent business activities indicate that landscaping appears to be the commercially useful function EMS performs.

Domiciled in Florida:

the applicant company's primary residence must be within the State of Florida.

According to the Articles of Incorporation, EMS is domiciled in Florida.

Ownership, Management and Control:

the ownership and control by minorities and/or women shall be real, substantial and continuing and shall go beyond the pro forma ownership of the firm as reflected in its ownership documents. The minority and/or woman owner shall enjoy the customary incidents of ownership and shall share in the risks and profits commensurate with their ownership interests as demonstrated by the substance rather than the form of arrangements. All securities which constitute ownership and/or control of a corporation for purposes of establishing it as an MBE shall be held directly by minorities and/or women. The contributions of capital or expertise by the minority and/or woman owner to acquire their interest in the firm shall be real and substantial. Examples of insufficient contributions include a promise to contribute capital, a note payable to the firm or its owners who are not MBE's or the mere participation as an employee, rather than a manager.

Our examination of financial records, other documents and discussions with the owner, officers and consultants, indicate that the owner and sole stockholder's management and control of EMS business activities is not Areal, substantial and continuing." Nor does the sole owner appear to "enjoy the customary incidents of ownership . . . " Documentation supporting this finding follows.

Our review of banking records disclosed that EMS's owner and sole stockholder does not have control of the cash account. The president and secretary/treasurer have sole signatory authority for disbursement of funds from the bank account. The owner does not have control over check signing and/or cash withdrawal for funds in his own company.

EMS's owner could not offer an explanation for the company's incorporation. He made vague references to a Mr. James Harvey, a former employee of the District, who he characterized as a consultant that maintains the corporate records.

Mr. Avery Milstead, who Mr. Garza identified as his brother-in-law, will play a significant

role in the management of EMS and has a consulting agreement with the company. We were informed by Mr. Milstead that the locktender proposal was prepared for EMS by Mr. James Harvey and Mr. Milstead and not the owner. The proposal states that Mr. Milstead will be responsible for the overall management of the locktender contract for EMS. Furthermore, the proposal indicates that Mr. Garza will report to Mr. Milstead and is identified separately as a field manager and/or a locktender.

Mr. Garza's inability to demonstrate real, substantial and continuing management and control of EMS business activities is further illustrated by the delegation of authority given to Mr. Milstead to make representations on behalf of EMS and bind the company without limitation of dollar magnitude. The president, a non-owner, is also empowered with the same authority. The owner was unaware of this delegation of authority. EMS's owner stated that Mr. Harvey may also have permission to bind EMS and, when questioned, expressed uncertainty as to whether a consultant's agreement between EMS and Mr. Harvey exists. While Mr. Garza attended the negotiation session for the proposed locktender contract, he was not an active participant; Mr. Milstead and Mr. Harvey negotiated the contract terms. In addition, EMS's attorney and accountant were engaged by Mr. Milstead.

Our review of corporate accounts reflect that Mr. Garza's contribution of capital has been limited to a personal vehicle and equipment. Despite repeated requests, we have not been provided with documentation to substantiate his ownership/title for assets he contributed. The overwhelming funding of the company's assets have been derived from loans and contributed capital of non-owners and related parties of Mr. Milstead.

Independence and Control:

An eligible minority business shall be an independent business. In determining this, the District shall consider the date the business was established, tax returns, the adequacy of its resources, and the degree to which financial, equipment leasing, and other relationships with non-minority firms vary from industry practice.

As described earlier, EMS and its owner have had a significant business relationship with Mr. Milstead, his relatives and companies (non-minority companies and individuals) and therefore, in our opinion, EMS is not an independent M/WBE. Our review of EMS's revenues and other transactions since inception through August 13, 1996, reveals that the majority of EMS's business activities has involved Mr. Milstead's companies or his relatives. These were not arms length transactions but rather were between related parties. We found that:

- ! Companies owned by Mr. Milstead or his relatives provided the majority of EMS's total revenue of \$24,411 and total cash receipts of \$25,721. Of the total revenue and

total cash receipts, \$13,386 and \$14,696 were related to Mr. Milstead or his relatives, respectively. Other revenues (from a single source) could easily have been diverted from Mr. Milstead's other companies that perform identical activities in order to create the perception that arms length transactions exist. There is no available evidence to suggest that Mr. Garza was responsible for obtaining any of the business on his own accord. Mr. Garza could not accurately depict the billing terms of work performed to date.

- ! Mr. Milstead is the lessor and owner of EMS offices at 13053 Bryan Road, Loxahatchee, Florida. According to the lease, EMS does not have to pay rent for the first six months of occupancy. The EMS Articles of Incorporation reference Mr. Milstead as the addressee for mail sent to EMS. This is also the principal address of Mr. Milstead's other businesses. These businesses are:

Florida State Construction, Inc.
Tree Mart Wholesale Outlet, Inc.
Palm Beach Sod and Soil, Inc.
Florida State Construction, Inc. d.b.a. Instant Landscaping

Mr. Garza, the president and the secretary/treasurer purportedly resigned from these businesses owned by Mr. Milstead to start EMS. According to Mr. Garza, EMS officers have not discussed formal or informal compensation arrangements and no salaries or profit sharing has been received after approximately five months of operations. According to a trial balance that was provided to us by EMS's accountant, there is \$11,000 in recorded but unpaid officer's compensation to date. It is unclear to whom these amounts are owed. The company has not recorded any other type of direct labor related expenses.

- ! EMS submitted a Consolidated Balance Sheet dated June 10, 1996, to the District with the proposal to perform locktender services listing assets valued at \$295,000. We found that there was insufficient documentation to substantiate the listed assets, which otherwise gives the misleading impression as to the adequacy of resources. The asset listing and subsequent trial balances that were provided to us by the company's outside accountant consist primarily of personal assets of the EMS owner, other officers, and relatives. According to corporate minutes, personal vehicles were transferred by the president and secretary who are non-owners. There is, however, no evidence that the non-owners have received any consideration to date for this transfer of assets. EMS has not provided documentation supporting and verifying the existence of these personal assets.

Day-to-Day Management:

the minority and or woman owner shall possess the power or cause the direction of the management and policy of the firm to make day-to-day, as well as major decisions on matters of management, policy and operations. The minority/woman business enterprise shall not be subject to any formal or informal restrictions which limit the customary discretion of the minority and/or woman owner. There shall be no restrictions through by-law provisions, or other provisions for cumulative voting rights or otherwise that prevent the minority or woman owner from making business decisions for the firm.

According to an agreement, Mr. Milstead is a consultant to EMS. The consulting agreement entered into on May 1, 1996, states that Mr. Milstead will receive a maximum commission of 5% of the net profits, plus expenses for EMS projects he is involved with. Mr. Garza and Mr. Milstead confirmed this commission arrangement. However, Mr. Milstead's preparation of the proposal, his management role in the proposed locktender contract, his ability to bind EMS, his participation in negotiations, his role as landlord, and parallel and related business interests demonstrates that Mr. Milstead is significantly more than a consultant and for all practical purposes appears to manage and control EMS's business activities. Also, this agreement appears to violate the commission fee clause of the locktender contract.

Other Applicable Considerations:

A business shall cooperate with the District in supplying additional information which may be requested in order to make an M/WBE eligibility determination.

We requested, in two letters dated August 9, 1996, and August 22, 1996, to EMS and its attorney, certain documentation necessary to our examination. The following items have not been provided:

- ! A complete and updated application from EMS. Our review of the original EMS Application for M/WBE Certification, dated March 27, 1996, indicated that the application was incomplete. We also requested that the application be updated for any activity (i.e. changes in ownership) subsequent to the filing date of March 27, 1996. We received from EMS an application (dated March 27, 1996) that answered items 1-7 below but did not include the required corporate seal. The information provided did not update M/WBE Application for activity subsequent to the filing date. The following omissions and deficiencies were noted:

1. A list of the current Board of Directors is not included on page 4 of the application.
2. Item D on page 4 of the application is not answered. This requests information

on previous Board of Directors and Principals if the corporation was acquired within the past five years. For clarity, this should have been marked "Not Applicable" by EMS.

3. Item 20 on page 7 of the application is not answered. This requests information concerning major creditors and contributed capital. (EMS's accountant provided trial balances which reflect account balances that include information about creditors and contributed capital).
4. Item 24 on page 8 of the application is not answered. This question solicits information concerning the company's subcontractors.
5. Item A on page 8 of the application is not answered. This question solicits information on whether the company performs work in the construction trade.
6. Item 25 on page 9 of the application is not answered. This question asks whether work is performed as a subcontractor and for whom.
7. Item 26 on page 9 of the application is not answered. It asks for a listing of three major projects completed by the company in the last year.
8. The corporate seal is not stamped on the signature page of the application.

! Canceled checks from the personal bank accounts of EMS officers supporting their contribution of cash as reflected in the EMS checkbook.

! Details of the \$30,000 cash in EMS's bank account, as reflected in its Consolidated Financial Statement. The M/WBE Application dated March 27, 1996, lists a net worth of \$5,000. However, a bank account was not established until May 14, 1996. The most recent trial balance provided by the EMS's accountant reflects a "Cash on hand & in bank" balance of only \$114.02 as of August 31, 1996.

! Titles to all vehicles and evidence of ownership of non-titled equipment. Also, documentation of balance owed on all vehicles and equipment.

! Personal checking account statements of officers since March 1996 to present.

! Personal tax returns of the owner and officers to verify their employment history.

EMS has refused to provide personal checking account statements of its officers and personal tax returns in violation of M/WBE Application's affidavit and M/WBE Certification Guidelines.

CONCLUSION

Based on our findings, we conclude that EMS does not meet the eligibility standards for M/WBE certification.

EMS has also failed to provide requested documentation in violation of the Affidavit and the District's M/WBE Certification Guidelines. Based on the limited amount of documentation available, we were unable to rule out whether or not EMS's incorporation and subsequent application and certification as a M/WBE may have been motivated by parties related to the owner attempting to capitalize on EMS's minority status, so as to obtain an unfair advantage over competitors through preferential treatment accorded to legitimate M/WBE firms.

Our audit also raises questions as to whether EMS has the independent financial resources necessary to successfully perform the contract. EMS would otherwise be substantially dependent on District progress payment funding in order to perform.

Our audit also raises concerns about whether EMS has violated District prohibitions relative to commission fee agreements. Violation of this clause of a District contract could result in termination.

RECOMMENDATIONS

1. The Office of Supplier Diversity and Outreach should initiate action to decertify EMS as a M/WBE.
2. Based on the information uncovered by this audit, the District should reconsider its proposed award of a locktender contract to EMS. In addition, the District should consider conducting debarment proceedings against EMS as well as its owner and related parties.